



Nick Durlacher
Chairman of the Balancing &
Settlement Code (BSC) Panel
ELEXON
4th Floor
350 Euston Road
London NW1 3AW

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value for all customers*

Your Ref:
Our Ref:
Direct Dial: 020 7901 7052
Email: Ian.Marlee@ofgem.gov.uk

Date: 7 November 2008

Dear Nick,

Draft Modification Proposal P227 'Extension of the definition of ECVAA systems to include the centrally provided communications network'

The Requirement Specification and Assessment Consultation for Draft Modification Proposal P227 'Extension of the definition of Energy Contract Volume Aggregation Agent ('ECVAA') systems to include the centrally provided communications network' (the "Draft Modification Proposal") has highlighted a number of key issues that the Settlement Standing Modification Group (SSMG) for P227 has been considering in developing the Draft Modification Proposal.

Ofgem considers that the discussion of these issues, and the analysis to support this discussion, is important in providing the Balancing and Settlement Code (BSC) Panel with adequate information with which to make a recommendation to the Authority on whether to implement the final proposal. Ofgem will consider the Panel's recommendation and the results of any analysis undertaken in reaching a decision on whether to implement the modification proposal when it is received. As such, Ofgem are keen for the SSMG to take a rigorous approach to examining the Draft Modification Proposal and therefore recommend that the BSC Panel direct the SSMG to undertake further analysis to support the development of the Draft Modification Proposal.

To assist the SSMG in identifying the relative benefits and disadvantages of the Draft Modification Proposal, as set out in their terms of reference, we consider that there are a number of specific areas that the SSMG should explore that will also assist the Authority in coming to its view. These areas include: an assessment of the current communication system and the way parties manage the risks associated with its failure; and a more comprehensive approach to assessing the potential impacts of the Draft Modification Proposal on the electricity balancing system. Further suggestions on how best to progress these issues are set out below:

1. Assessing the current communication system and managing risks

Ofgem considers that in assessing the potential defect and proposed solution identified in the Draft Modification Proposal, the SSMG should examine the ability of the current communication service provisions to deliver parties' requirements. This should include identifying the relative benefits and disadvantages of these provisions, to all parties, particularly in terms of their ability to manage the risk of communication failures.

To assist with this, Ofgem considers that it would be helpful for the following areas to be further examined:

a. Where to draw the line between communication services, ELEXON central systems and Parties' systems:

This would involve assessing the impact the current boundary between the ECVA and central communication system has on parties' ability to manage the risks of a communication failure and the associated incentives. This should include examining the change in current boundary definitions, as proposed by P227, as well as other possible alternative boundary definitions.

b. Best practice and level of choice for communication services in other markets:

Secondly, it may also be appropriate to gather information, preferably from an independent source with knowledge and experience in IT systems and energy economics, to examine best practice and level of choice for communication services in other markets.

This would involve identifying and assessing communication systems in other markets (e.g. financial and commodities markets) that utilise similar communication systems. This could also involve assessing whether the communication systems in these other markets are designed to enable parties to elect to obtain different communication service levels with, for example, different levels of back up and reliability, or whether communication services are provided in these other markets on a less diverse basis with little differentiation in service levels for different users. The SSMG should compare and contrast information provided on these communication systems with the current centrally provided communication service and identify practices that could assist parties in managing the risk of a communication failure.

c. Barriers to entry:

Thirdly, we recommend work to identify potential barriers to industry participants and specialist companies providing or using their own communication services to submit contract notification information directly to Elexon's central systems. In particular, this would include examining the contractual arrangements between Elexon and Logica to assess whether these impact on the ability of other specialist communication service providers to provide high grade communication services. This should also include possible solutions to these barriers and the associated costs. Ofgem considers that this information would assist in examining alternative methods parties could use to manage the risk of a communication failure.

2. Assessing potential impacts of the draft modification proposal on the balancing regime

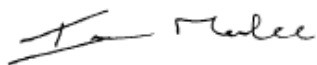
The notification submission process plays a key role in the electricity cash-out regime and, as such, in providing incentives on parties to balance. Consequently, this assists National Grid Electricity Transmission (NGET) in balancing the electricity system.

Ofgem considers that, to fully understand the impact of the Draft Modification Proposal, it would be helpful for the SSMG to request analysis from NGET on the proposal's potential impact on the electricity balancing mechanism and on National Grid's balancing costs. This should include scenarios that consider the potential risks and estimated costs of a failure in the communication systems that underpins the contractual notification process and potential impacts on security of supply and system balancing, during peak and off-peak periods. There should also be scenarios that consider the potential impact the Draft Modification Proposal could have on these issues, if it was implemented.

We anticipate that the analysis highlighted above will provide further information to help the Panel assess and make a recommendation on the Draft Modification Proposal.

I hope the BSC Panel find these recommendations helpful.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Ian Marlee', with a stylized flourish at the end.

Ian Marlee
Director, Trading Arrangements